

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 200

June 17, 1957

COMMENCING CORPORATIONS: REORGANIZATION OF COMMENCING CORPORATIONS

Syllabus:

When a commencing corporation reorganizes, both the transferor and the transferee corporations are subject to the provisions of Sections 23222 and 23222(a).

X, a Massachusetts corporation, qualified to and began doing business in California on December 29, 1953. A return was filed under the Bank and Corporation Tax Law for the income year ending December 31, 1953 showing the minimum tax due. On May 31, 1954, X changed its tax year to a May fiscal and filed a return for the period January 1, 1954 to May 31, 1954. On March 1, 1955, X ceased doing business in California and through a reorganization transferred its California assets and business to its wholly owned subsidiary, Y, who qualified on December 28, 1954, and began doing business on March 1, 1955. For the year of reorganization X filed a return for the income year ending May 31, 1955, reflecting its operations for the period June 1, 1954 to February 28, 1955, and Y filed a separate return for the period March 1, 1955 to May 31, 1955. The first complete return covering a full twelve months operations by either corporation was the return filed by Y for the period June 1, 1955 to May 31, 1956. Advice has been requested as to what is the proper basis for assessment of returns filed for the year in which the reorganization occurred and whether an assessment under Section 23222 is proper for the income year ending May 31, 1956.

Section 23222(a) provides that, "In every case in which the second or succeeding taxable years of a commencing corporation constitute a period of less than 12 months . . . the tax for such year or years shall be measured by the income of that period subject to the continuation of the prepayment procedure outlined in Section 23222". X appears to come squarely within this provision of this section since its returns for the period ending December 31, 1953, May 31, 1954 and May 31, 1955 (actually covering its period of operations from June 1, 1954 to February 28, 1955) all covered periods of less than twelve months operations. Accordingly, the taxes for these periods must be measured by the income of the same periods as provided in Section 23222(a).

Sections 23252, 23253(a), and 23254 (all relating to corporations commencing to do business pursuant to a reorganization) have no application in the case of the reorganization of a commencing corporation. Sections 23222 and 23222(a) set up a pattern whereby a corporation cannot pay its tax in advance until it has experienced a full twelve months operations within one taxable year. These sections are stated to apply "in every case" where the first or succeeding years operations are for a period of less than twelve months. Where a reorganization occurs before the transferor has completed his

prepay experience the reorganization merely prolongs the application of Sections 23222 and 23222(a) and, until the transferee has experienced a complete twelve months operations, there is no advance payment of the tax. This follows from the principle that the taxes of a commencing corporation are controlled entirely by the provisions of Section 23222 and 23222(a) to the exclusion of all other sections. See Appeal of Sacramento Valley Tractor Co., State Board of Equalization, May 5, 1953, and the Superior Court opinion in the same case, rendered on May 23, 1956. An appeal is now pending with the District Court of Appeals.

Reg. 23251-23254 provides in part:

"Whenever a transferor in reorganization is a commencing corporation as defined in Section 23222, its income shall be used as the measure of its tax for any period prior to reorganization that its tax is computed under Section 23222 and 23222(a).

Whenever a transferee in reorganization is a commencing corporation as defined in Section 23222, its tax for the period in which the reorganization occurred shall be measured by its entire income, including income derived from the business and property transferred subsequent to the date of reorganization".

These provisions in the regulations confirm the view that when a commencing corporation reorganizes, both transferor and transferee corporations are subject to the provisions of Sections 23222 and 23222(a). The first paragraph clearly provides that for all periods prior to the transfer, the transferors taxes are computed under the provisions of Sections 23222 or 23222(a). In the instant case this authorizes a tax for taxable year ending May 31, 1955 measured by the transferor's income for the period June 1, 1954 to February 28, 1955.

The second paragraph dealing with the transferee provides in effect that if the transferee succeeds to the operations of a commencing corporation, it in turn becomes a commencing corporation and its tax for the year of transfer is computed under the provisions of Section 23222 and 23222(a). As applied in the instant case this provision authorizes a tax for the taxable year ending May 31, 1955, measured by the transferee's income for the period March 1, 1955 to May 31, 1955.

Consequently, separate returns are required from both corporations for the income year ending May 31, 1955. The income of X for this period will measure the tax for its taxable year ending May 31, 1955 as provided in Section 23222(a). Since Y is also a commencing corporation, Section 23222(a) requires that its income for the income year ending May 31, 1955 serve as the measure of its tax for the taxable year ending May 31, 1955, and as a prepayment of its tax for the taxable year ending May 31, 1956. As transferee of the parent's taxes under Sections 25701 et seq. Y is liable for payment of all taxes from both corporations.

Further, Y, as a commencing corporation must continue the prepay procedures

of Sections 23222 and 23222(a) until it operates for a full twelve months in one taxable year. Since the return for income year May 31, 1956 is the first return covering a full twelve months operations, the income of that period will measure the tax for taxable year ending May 31, 1956, if greater than the prepayment, and also serve as the measure of the tax for the taxable year ending May 31, 1957.